

Oversight Report



QUALITY CONTROL REVIEW OF KPMG PEAT MARWICK LLP
THE UNIVERSITY OF DELAWARE
FISCAL YEAR ENDED JUNE 30, 1998

Report Number PO 99-6-003

March 26, 1999

Office of the Inspector General
Department of Defense

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Acronyms

DoD	Department of Defense
OMB	Office of Management and Budget
UD	University of Delaware



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MAR 26 1999

SUBJECT: Quality Control Review of KPMG Peat Marwick LLP
The University of Delaware
Fiscal Year Ended June 30, 1998
Report No. PO 99-6-003 (Project No. 90A-9016)

Introduction

We are providing this report for your review and comment. The Wilmington, Delaware, office of KPMG Peat Marwick LLP (KPMG) performed the Single Audit for the University of Delaware (UD), a nonprofit organization. The audit is required by Office of Management and Budget (OMB) Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations." For the fiscal year ended June 30, 1998, UD reported total Federal expenditures of \$49,940,917, representing \$10,099,703 for the Department of Defense (DoD) and \$39,841,214 for other Federal agencies.

The KPMG audit report, dated October 2, 1998, includes a report with an unqualified opinion on the UD financial statements, a report on internal controls and compliance related to the financial statement audit, and a report on compliance applicable to each major program and internal control in accordance with OMB Circular A-133.

KPMG issued an unqualified opinion on compliance and internal control over financial reporting based on an audit of financial statements performed in accordance with *Government Auditing Standards*.

The KPMG report states that the auditors obtained an understanding of the internal controls related to Federal research and development awards and prepared an audit report on compliance with requirements applicable to each major program and on internal control compliance in accordance with OMB Circular A-133. The audit report describes the auditors' scope of work in obtaining that understanding and in assessing control risk. The audit report further describes the significant internal controls and

control structure, including statements on reportable conditions, material weaknesses, and controls that provide reasonable assurance that Federal awards are being managed in accordance with applicable laws and regulations.

Quality Control Review Results

In our opinion, the audit performed by KPMG generally meets the applicable guidance and regulatory requirements of OMB Circular A-133 and its related Compliance Supplement, which incorporate generally accepted auditing standards and *Government Auditing Standards*. However, some problems were identified. The audit contains inadequate working paper documentation as described in the following paragraphs.

Material Finding: Working Paper Documentation & Referencing

KPMG did not provide adequate working paper support for its compliance testing on the allowable costs/cost principles requirement. *Government Auditing Standards* 4.35 requires auditors to provide documentation in their working papers so that another auditor, having no prior connection with the audit, could ascertain from them the evidence supporting the significant conclusions and judgments. KPMG documented its entire compliance test work related to the allowable costs/cost principles requirement on only one page in the audit working papers and did not identify the attributes tested for each sample item selected. To perform an adequate allowability assessment of sampled transactions, the auditors should determine whether or not the transactions tested were properly allowable and reasonable, and that indirect costs had been properly charged, if applicable. Only after assessing each transaction in that way, should the auditor determine whether or not the entity complied with the allowable costs/cost principles requirement. At a minimum, the auditors should have performed separate tests on the allowability of each of the 33 items selected. KPMG, however, only reached the overall conclusion that all of the transactions were appropriately approved and did not refer to the allowability of the selected transactions. We therefore do not believe that the documentation was adequate to support its position that UD complied with the allowable costs/cost principles requirement. The auditors did not provide adequate support for their compliance tests because they made an inappropriate judgment about what documentation was necessary to support their conclusion. We therefore could not identify the criteria used by KPMG to conclude that each of the selected transactions was allowable.

The KPMG audit working paper files for UD also contained at least three separate references to a working paper supporting a sample of Federal award expenditures. The references indicated that a working paper documented the results of compliance tests on a sample of 25 Federal award expenditures. We could not find the working paper referred to in these references or a detailed sample of 25 Federal award expenditures. We found only the working paper supporting a sample of 33 Federal award

expenditures, referred to in the previous paragraph. Because of the incorrect references, we could not determine whether the references were incorrect or if a working paper was actually missing from the file. We therefore could not determine whether the proper audit work was performed to support the auditor's conclusions on the compliance with allowable costs/cost principles requirement.

Recommendations

We recommend that KPMG Peat Marwick:

- (1) Provide our office documentation to support its conclusion that the transactions tested for compliance with the allowable costs/cost principles requirement were allowable. The documentation should identify the specific attributes tested for each sample transaction that supports its overall conclusion regarding allowable costs/cost principles requirement compliance.
- (2) Correct the references to the audit compliance test work for the allowable costs/cost principles requirement in the existing working papers.

Quality Control Review Objective

The objective of our quality control review was to ensure that the audit was conducted in accordance with applicable standards and meets the auditing requirements of OMB Circular A-133. As the Federal cognizant agency for UD, we conducted a quality control review of the KPMG audit working papers for its audit of UD. We focused our review on the following qualitative aspects of the audit: auditor qualifications, independence, due professional care, quality control, planning, supervision, major program determinations, and the Schedule of Federal Awards of UD.

We reviewed the most recent peer review letter, issued November 8, 1996, by Price Waterhouse LLP for KPMG. The peer review letter stated that KPMG met the objectives of the quality control review standards established by the American Institute of Certified Public Accountants and that the standards were being complied with during the fiscal year ended March 31, 1996.

Scope and Methodology

We used a draft of the upcoming 1999 edition of the Uniform Quality Control Guide for A-133 Audits (the Guide) to perform our review. The final version of the Guide will be approved by the President's Council on Integrity and Efficiency as guidance for performing the quality control review procedures. The Guide is organized by the general and fieldwork audit standards and the required elements of a single audit. Our

review was conducted from January 6 through 8, 1999, and covered areas related to the financial statements and the research and development program. We did not review compliance with requirements related to the other "Type A" programs, as defined by OMB Circular A-133. The other Type A programs at UD for FY 1998 were the Student Financial Aid program for the Department of Education and the Cooperative Extension program for the U.S. Department of Agriculture.

Results of Prior Quality Control Reviews

Since January 1, 1996, we have performed seven quality control reviews of KPMG. We identified conditions resulting in quality control review findings and made recommendations at several KPMG locations. We notified the affected offices, and no further action is necessary.

Background

The Inspector General Act of 1978, Public Law 95-452, prescribes the duties and responsibilities of that office. In implementing those responsibilities, the Inspectors General are required to "take appropriate steps to assure that any work performed by non-Federal auditors complies with the standards established by the Comptroller General."

The Single Audit Act of 1984 (Public Law 98-502) and the Single Audit Act Amendments of 1996 are intended to improve the financial management of States, local governments, and nonprofit organizations whose total annual expenditures of Federal awards are \$300,000 or more; establish uniform requirements for audits of Federal financial assistance; promote efficient and effective use of audit resources; and ensure that Federal departments and agencies rely on and use the audit work done under the Act, to the maximum extent practicable.

The OMB Circular A-133 establishes the Federal audit and reporting requirements for nonprofit and educational institutions whose expenditures of Federal awards are or exceed \$300,000 annually. The Circular provides that an audit made in accordance with the Circular shall be in lieu of any financial audit required under individual Federal awards. Federal agencies must rely on the audit to the extent that it meets their individual needs. The Circular also requires that the cognizant agency obtain or conduct quality control reviews of selected audits made by non-Federal auditors and provide the results, when appropriate, to other interested organizations. The Circular

was issued on June 30, 1997, to incorporate the changes in the Single Audit Act Amendments of 1996. Its provisions apply to audits of fiscal years beginning after June 30, 1996.

Discussion of Results

During our quality control review, we reviewed and took no exception to the working papers supporting the following reports prepared by KPMG.

Independent Auditors' Report on Basic Financial Statements for the Year Ended June 30, 1998. The auditor is required to obtain reasonable assurance about whether the financial statements are free of material misstatement. We reviewed the audit program and the testing of evidential matter to determine whether testing was sufficient, based on an assessment of control risk, to warrant the conclusion reached and whether the working papers supported the conclusion.

Independent Auditors' Report on Compliance and on Internal Control over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*. The auditor is required to assess control risk to determine the degree of reliance to place on the internal control structure. The auditor must perform tests of controls to evaluate the effectiveness of the design and operation of the policies and procedures in preventing or detecting material noncompliance, and to review the system for monitoring subrecipients and obtaining and acting on subrecipient audit reports. The auditor is also required to determine whether UD has complied with laws and regulations that may have a direct and material effect on the financial statements. We reviewed the audit program for the appropriate procedures, the working paper documentation, and the results of the testing of controls.

During our quality control review, except for the deficiencies related to allowable costs/cost principles requirement compliance, we reviewed and took no exception to the working papers supporting the following report prepared by KPMG.

Independent Auditors' Report on Compliance with Requirements Applicable to Each Major Program and Internal Control Compliance in Accordance With OMB Circular A-133. The auditor is required to determine whether the recipient has complied with laws and regulations that may have a direct and material effect on any of its major Federal programs. We reviewed the audit program for the appropriate procedures, ensured that the auditors considered each of the 14 requirements included in the Compliance Supplement, reviewed the working paper documentation and support, and reviewed the compliance tests performed.

Comments

Because this report contains findings and recommendations, written comments are required by May 26, 1999. If you have questions on this report, please contact Ms. Barbara Smolenyak at (703) 604-8761 or by e-mail at bsmolenyak@dodig.osd.mil. The report distribution is the enclosure.

A handwritten signature in black ink, reading "Donald E. Davis". The signature is written in a cursive style with a large, stylized "D" and "D" at the beginning and end.

Donald E. Davis
Deputy Assistant Inspector General
for Audit Policy and Oversight

Enclosure

**The University of Delaware
Fiscal Year Ended June 30, 1998**

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Enclosure

Evaluation Team Members

This report was prepared by the Financial, Performance, and Single Audits Division,
Office of the Deputy Assistant Inspector General for Audit Policy and Oversight, DoD.

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